

## Message Text

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ACTION EB-07

INFO OCT-01 EUR-12 EA-09 IO-11 ISO-00 SP-02 AID-05 NSC-05

CIEP-02 TRSE-00 SS-15 STR-04 OMB-01 CEA-01 CIAE-00

COME-00 FRB-01 INR-07 NSAE-00 USIA-15 XMB-04 OPIC-06

LAB-04 SIL-01 L-03 H-02 PRS-01 PA-02 /121 W

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R 300650Z JAN 76

FM AMEMBASSY TOKYO

TO SECSTATE WASHDC 6493

INFO USDEL MTN GENEVA

USMISSION OECD PARIS

UNCLAS TOKYO 1409

E.O. 11652: N/A

TAGS: ETRD, EAID, JA

SUBJECT: GOJ DECIDES TO INTRODUCE PLANT EXPORT LOSS RESERVE  
SYSTEM

REF: 75 TOKYO 14794 AND PREVIOUS

SUMMARY. GOJ PLANS TO ESTABLISH PLANT EXPORT LOSS RESERVE  
SYSTEM UNDER WHICH UP TO 7 PERCENT OF ANNUAL PROJECT COST WOULD  
BE DEDUCTIBLE FROM TAXABLE INCOME AS RESERVE AGAINST LOSS.  
HOWEVER, SINCE DEDUCTIBLE AMOUNT BECOMES TAXABLE IF LOSS DOES  
NOT OCCUR, AND LOSSES SUSTAINED WOULD HAVE BEEN DEDUCTIBLE  
FROM TAXABLE INCOME IN ANY EVENT, RESERVE SYSTEM POSTPONES BUT  
DOES NOT TAXES WHICH WOULD OTHERWISE BE PAYABLE. IN EMBASSY  
VIEW, SYSTEM DOES NOT APPEAR TO PROVIDE SIGNIFICANT SUBSIDY TO  
PLANT EXPORTS. END SUMMARY.

1. ON JAN 23 EMBOFF REVIEWED WITH MITI OFFICIAL (INOUE,  
DEPUTY DIR, ECONOMIC COOPERATION DIV) PRESENT STATUS OF PROPOSED  
PLANT EXPORT LOSS RESERVE SYSTEM, AS WELL AS REPORTED GOJ INTENT  
TO INCREASE AID FUNDS AVAILABLE TO CONDUCT FEASIBILITY  
STUDIES FOR LARGE SCALE OVERSEAS PROJECTS IN DEVELOPING  
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COUNTRIES. INOUE PROVIDED FOLLOWING INFORMATION:

2. PLANT EXPORT LOSS RESERVE SYSTEM: GOJ HAS DECIDED TO IMPLEMENT SCALED-DOWN VERSION BEGINNING JFY 76 (APRIL 1, 1976), AND NECESSARY IMPLEMENTING LEGISLATION WILL BE SENT TO PRESENT DIET SESSION AS BUDGET-RELATED BILL. PASSAGE IS ANTICIPATED. SYSTEM WILL BE IMPLEMENTED AS PART OF EXISTING QTE OVERSEAS INVESTMENT, ETC. LOSS RESERVE SYSTEM UNQTE RATHER THAN AS SEPARATE NEW SYSTEM. SYSTEM WILL BE APPLICABLE ONLY TO EXPORTS TO DEVELOPING COUNTRIES SATISFYING ALL OF FOLLOWING CRITERIA:

A) GOJ AND LDC GOVT MUST HAVE AGREED THAT GOJ WILL COOPERATE IN IMPLEMENTATION OF PARTICULAR PLANT EXPORT PROJECT IN QUESTION;  
B) TOTAL CONTRACT PRICE MUST EXCEED 100 BILLION YEN (330 MILLION DOLS AT 303 YEN/DOLLAR);  
C) PERIOD OF TIME BETWEEN SIGNING OF CONTRACT AND FIJAL DELIVERY MUST EXCEED THREE YEARS; AND  
D) AN ORDER FOR THE PLANT EXPORT IN QUESTION MUST HAVE BEEN PLACED BY THE LDC GOVT OR OTHER OFFICIAL HOST COUNTRY AUTHORITY.

3. FOR TRANSACTIONS SATISFYING THE ABOVE CRITERIA, JAPANESE FIRMS MAY ANNUALLY PLACE UP TO 7 PERCENT OF PROJECT-RELATED EXPENSES INCURRED DURING THAT YEAR INTO A LOSS RESERVE. (MITI HAD ORIGINALLY HOPED THAT 25 PERCENT OF CONTRACT VALUE COULD BE PLACED INTO RESERVE.) FUNDS PLACED INTO RESERVE WILL NOT BE TAXED AS INCOME. SIMPLE ACCOUNTING TRANSACTION WILL BE SUFFICIENT FOR FIRM TO BENEFIT FROM FAVORABLE TAX TREATMENT; SYSTEM WILL NOT REQUIRE THAT FUNDS ACTUALLY BE SET ASIDE. UPON PROJECT'S COMPLETION, RESERVE MUST BE USED TO OFFSET LOSSES, IF ANY. IF PROJECT RESULTS IN PROFIT, RESERVE FUNDS ARE TRANSFERRED BACK TO COMPANY'S ORDINARY INCOME AND SUBJECT TO USUAL TAXATION.

4. IN EXPLAINING SYSTEM, INOUE STRESSED THAT SYSTEM'S PURPOSE IS FURTHERING IMPELEMNTATION OF LARGE SCALE ECONOMIC COOPERATION PROJECTS IN DEVELOPING COUNTRIES  
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WHICH ARE OBJECTS OF INTER-GOVERNMENTAL AGREEMENTS, RATHER THAN EXPORT PROMOTION PER SE. HE ALSO NOTED RUEFULLY THAT SYSTEM HAD HAD TO BE SCALED DOWN FROM MITI'S ORIGINAL PROPOSAL AND THAT ACTUAL IMPACT OF SYSTEM AS NOW ENVISAGED WOULD NOT BE GREAT. HE NEVERTHELESS DEFENDED SYSTEM AS NECESSARY AND DESIRABLE FOR LARGE SCALE PLANT EXPORTS, WHICH, HE SAID, CONSTITUTE ONLY SMALL PART OF TOTAL JAPANESE PLANT EXPORTS.

5. INOUE SAID THAT MITT'S JFY 76 BUDGET INCLUDED 2,815 MILLION YEN (9.29 MILLION DOLS) FOR JAPAN INTERNATIONAL COOPERATION AGENCY (JICA). JICA WILL USE MONEY FOR TECHNICAL ASSISTANCE TO LDC'S, SUCH AS PERFORMANCE OF PROJECT FEASIBILITY STUDIES. INCLUDED IN ABOVE AMOUNT, AND IN BUDGRT FOR FIRST TIME IN JFY 76, IS 266 MILLION YEN (870 THOUSAND DOLS) FOR FEASIBILITY STUDIES FOR LARGE SCALE PROJECTS, I.E. THOSE OVER 100 BILLION YEN MAGNITUDE. ELIGIBLE PROJECTS WILL BE LIMITED TO THOSE FOR WHICH LDC GOVT HAS REQUESTED, AND JAPANESE GOVT PROMISED, ASSISTANCE. PERFORANCE OF FEASIBILITY STUDY WILL BE IN NATURE OF GRANT TECHNICAL ASSISTANCE AND THERE IS NO PROVISION FOR REIMBURSEMENT BY LDC GOVT OR BY JAPANESE FIRM WHICH MIGHT SUBSEQUENTLY WIN CONTRACT TO PERFORM PROJECT FOR WHICH FEASIBILITY STUDY IS CONDUCTED. HOWEVER, NEITHER IS THERE REQUIRED ANY LDC GOVT PROMISE, AS CONSIDITION FOR JAPANESE PERFORMANCE OF FEASIBILITY STUDY, TO AWARD CONTRQCT FOR PROJECT PROPER TO JAPANESE FIRM. THUS, SAID INOUE, THIS MEASURE AS WELL AS PLANT EXPORT LOSS RESERVE SYSTEM SHOULD BE REGARDED AS ECONOMIC COOPERATION RATHER THAN EXPORT PROMOTION.

6. EMBASSY COMMENT. WE DO NOT SEE ANY PARTICULAR MERIT IN A DISTINCTION BETWEEN QTE ECONOMIC COOPERATION UNQTE AND QTE EXPORT PROMOTION UNQTE FOR THESE PURPOSES. HOWEVER, BASED ON OUR UNDERSTANDING OF HOW PLANT EXPORT LOSS RSRVE SYSTEM WOULD WORK, T DOES NOT APPEAR TO PROVIDE A SIGNIFICANT SUBSIDY TO PLANT EXPORTS. ALTHOUGH UP TO 7 PERCENT OF ANNUAL PROJECT COST WOULD BE DEDUCTIBLE FROM TAXABLE INCOME AS RESERVE AGAINST LOSS, THE DEDUCTED AMOUNT, WE ARE TOLD, IS TO BECOME UNCLASSIFIED

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TAXABLE IF THE LOSS DOES NOT OCCUR. ON THE OTHER HAND, LOSSES WHICH ARE IN FACT SUSTAINED WOULD HAVE BEEN DEDUCTIBLE FROM TAXABLE INCOME IN ANY EVENT. RESERVE SYSTEM DOES NOT THEREFORE APPEAR TO ELIMINATE TAXES WHICH WOULD OTHERWISE BE PAYABLE. IT IS TRUE THAT JAPANESE PERFORMANCE ON GRANT AID BASIS OF ADDITIONAL FEASIBILITY STUDIES (PARA 5 ABOVE) MAY RESULT IN ULTIMATE AWARD OF SOME ADDITIONAL CONTRACTS TO JAPANESE FIRMS DUE TO LDC GOVT GRATITUDE AS WELL AS LIKELIHOOD STUDIES MAY RESULT IN PROJECT SPECIFICATIONS FAVORABLE TO JAPANESE FIRMS. THIS HOWEVER SEEMS TO FALL WITHIN COMMONLY ACCEPTED INTERNATIONAL AID PRACTICES. END COMMENT.  
HODGSON

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**To:** STATE  
**Type:** TE  
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